

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #06-33**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether income from the origination fees and brokerage commissions are subject to business tax.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (G) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[SUBSIDIARY] is a wholly-owned subsidiary of [BANK]. [SUBSIDIARY] originates loans through [LANGUAGE REDACTED], maintains correspondent and broker relationships in [LANGUAGE REDACTED] and services loans in [LANGUAGE REDACTED].

In the ordinary course of its residential mortgage business, [SUBSIDIARY] forms joint ventures with (i) residential real estate brokerage companies and (ii) residential real estate developers for the purpose of originating mortgages for home buyers. These joint ventures are typically formed as limited liability companies with [SUBSIDIARY] and the real estate brokerage or development entity as the joint venture members. [LIMITED LIABILITY COMPANY], an indirect subsidiary of [SUBSIDIARY], serves as the sole Manager of these joint ventures. The sole purpose of this joint venture is to originate and then broker residential mortgage loans to [SUBSIDIARY] and other mortgage lender companies. In order for [TAXPAYER] to broker the originated loans, [TAXPAYER] will enter into mortgage brokerage agreements with [SUBSIDIARY] and other residential mortgage lender companies. [SUBSIDIARY] and the other residential mortgage lender companies extend credit by entering into a residential mortgage loan with individuals who have chosen to buy a home within the real estate development in question. In exchange for [TAXPAYER'S] mortgage origination and brokerage services, [TAXPAYER] is entitled to mortgage origination fees and brokerage commissions. These mortgage origination fees and brokerage commissions are [TAXPAYER'S] sole source of income.

ISSUE

Are the origination fees and brokerage commissions, paid to the Taxpayer, subject to the business tax found in Tenn. Code Ann. § 67-4-701 *et seq.*?

RULING

No. The origination fees and brokerage commissions, paid to the Taxpayer, are not subject to the business tax found in Tenn. Code Ann. § 67-4-701 *et seq.*

ANALYSIS

The Business Tax Act, Tenn. Code Ann. § 67-4-701, *et seq.*, is a component of Tennessee's privilege taxes. The tax is imposed upon the privilege of engaging in business in Tennessee. It allows counties and incorporated municipalities to tax the privilege of engaging in any of the business activities enumerated in the Business Tax Act, where such business activity is carried on in that locality. The express intent of the legislature is to impose the business tax, within the framework of the Business Tax Act, to the fullest extent permitted under the constitutions of the United States and the State of Tennessee. Tenn. Code Ann. § 67-4-701(c).

Tenn. Code Ann § 67-4-708(3)(C) includes as a taxable privilege on the “making of sales of services or engaging in the business of furnishing or rendering services.” The Business Tax Act then lists fifteen categories of services that are excluded from taxation. Tenn. Code Ann. § 67-4-708(3)(C)(i)-(xv). One of the excluded categories of service includes persons engaged in the business of extending credit and provides as follows:

Services furnished by institutions which are engaged in deposit banking or closely related functions, including fiduciary activities, services furnished by persons engaged in extending credit or lending money except persons taxable under subdivision (5); services furnished by establishments engaged in the underwriting, purchase, sale or brokerage of securities on their own account or on the account of others; services furnished by exchanges, exchange clearing houses and other services allied with the exchange of securities and commodities; services furnished by investment trusts, investment companies, holding companies and commodity trading companies.

Tenn. Code Ann. § 67-4-708(3)(C)(x). In addition to the specific exemptions set forth in Tenn. Code Ann. § 67-4-708(3)(C), the statute provides as follows:

It is the legislative intent that the exceptions shown below shall include the sales of services by those businesses or establishments so described in the Standard Industrial Classification Index of 1972, including all supplements and amendments prepared by the bureau of the budget of the federal government, except where otherwise provided.

Tenn. Code Ann. § 67-4-708(3)(C).

As provided in the statute, in order to evaluate a claim for exclusion or exemption from the business tax, courts look to the Standard Industrial Classification Manual (SIC) and its supplements and amendments to determine the meaning of the various excepted services under that classification system. *Aabakus, Inc. v. Johnson*, 1996 WL 548148 at 3 (Tenn. Ct. App. 1996). The 1987 version of the SIC is the one currently applicable to the business tax. Office of Management and Budget, Executive Office of the President, Standard Industrial Classification Manual of 1987 (1987) (the “1987 SIC Manual”).

Within Major Group 61 (Non-depository Credit Institutions which include establishments engaged in the business of extending credit in the form of loans, but not engaged in deposit banking) of the 1987 SIC Manual is Industry Group 616 (Mortgage Bankers and Brokers). Within Industry Group 616 is Industry Number 6163 (Loan Brokers) which is described as follows:

6163 Loan Brokers

Establishments primarily engaged in arranging loans for others. These establishments operate mostly on a commission or fee basis and do not ordinarily have any continuing relationship with either borrower or lender.

- Agents, farm or business loan
- Brokers, farm or business loan
- Loan agents
- Loan brokers
- Mortgage brokers arranging for loans but using money of others

The only business of the Taxpayer is to solicit or broker loans on behalf of and for the benefit of [SUBSIDIARY] and other mortgage lender companies. This activity clearly falls within the scope of Industry Number 6163 (Loan Broker) because the Taxpayer is engaged in arranging loans for others. Accordingly, the Taxpayer is covered by Major Group 61 from the 1987 SIC Manual which includes services furnished by persons engaged in extending credit.¹ Finally, since the Taxpayer's activities are covered by the SIC Manual as persons engaged in extending credit and one of the exceptions listed in Tenn. Code Ann. § 67-4-708(3)(C) provides an exemption for persons engaged in extending credit, the Taxpayer falls under such exemption and is thus exempt from business tax.

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APPROVED: Loren L. Chumley
Commissioner

DATE: 9/18/06

¹ Pursuant to Tenn. Code Ann. § 67-4-708(3)(C)(x), the Taxpayers would not be exempt if they fell under Tenn. Code Ann. § 67-4-708(5). Tenn. Code Ann. § 67-4-708(5) includes persons required to obtain a certificate and a license from the Commissioner of Financial Institutions under the provisions of Title 45, Chapter 5, such as an industrial loan and thrift company, defined under Tenn. Code Ann. § 45-5-102. Under the facts provided, the Taxpayers are not required to obtain such a certificate and license and therefore do not fall under subdivision (5).